



STATEMENT OF ACTIVITIES

Magellan Health Services of Arizona, Inc.
Year Ended June 30, 2008
With Report of Independent Auditors

Ernst & Young LLP



Magellan Health Services of Arizona, Inc.

Statement of Activities

Year Ended June 30, 2008

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Report of Independent Auditors

Magellan Health Services of Arizona, Inc.

We have audited the accompanying statement of activities as defined in the ADHS-DBHS Financial Reporting Guide for Regional Behavioral Health Authorities and Tribal Behavioral Health Authorities dated July 1, 2007 within the contract between Magellan Health Services of Arizona, Inc. (The Company) and the Arizona Department of Health Services – Division of Behavioral Health Services (ADHS-DBHS), for the year ended June 30, 2008. This statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement of activities is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement of activities. An audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The statement of activities is prescribed by the ADHS-DBHS Financial Reporting Guide for Regional Behavioral Health Authorities and Tribal Behavioral Health Authorities of the contract between the Company and ADHS-DBHS dated July 1, 2007.

In our opinion, the statement referred to above presents fairly, in all material respects, the operating results of Magellan Health Services of Arizona, Inc. for the year ended June 30, 2008, on the basis of the contract referred to in the proceeding paragraph.

This report is intended solely for the information and use of the Arizona Department of Health Services – Division of Behavioral Health Services, the State of Arizona, and the Board of Directors and management of Magellan Health Services, Inc., and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

December 17, 2008

Magellan Health Services of Arizona, Inc.

Statement of Activities

June 30, 2008

**Disclose on Schedule A

		TXIX Child	TXIX CMDP	TXIX DD Child	NTXIX/XXI Child	TXXI Child	HB2003 Child	TXIX SMI	TXIX DD ADULT	NTXIX/XXI SMI	HIFA II SMI	TXXI Adult	SSDI – TMC	TXIX GMHSA	HIFA II GMH	MENTAL HEALTH	Substance Abuse	prevention intervention	PASRR	ADHS DOC	Other	Sub Total	Program Admin & Mgmt/Gen	Total
REVENUES																								
Revenue Under ADHS Contract																								
401	ADHS Revenue	\$ 79,600,964	\$ 38,940,915	\$ 5,504,964	\$ 6,244,943	\$ 6,726,993	\$ –	\$ 195,256,147	\$ 5,861,600	\$ 69,275,818	\$ 1,152,143	\$ 261,659	\$ –	\$ 71,531,999	\$ 1,068,900	\$ 1,930,057	\$ 18,814,194	\$ 5,005,162	\$ 39,000	\$ 1,576,068	\$ –	\$ 508,791,526	\$ –	\$ 508,791,526
a	ADHS Revenue – Qualifying Incentive Payments	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
402	Specialty & Other Grants*	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
403	Client Fees (Co–pays)	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Third Party Recoveries																								
a	Medicare	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
b	Other Insurance	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
405	Interest Income	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1,917,824	1,917,824
406	Other Funding Sources – Non ADHS*	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
407	Unrelated Business Activities*	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	(6,219)	(6,219)
408	TOTAL REVENUE	\$ 79,600,964	\$ 38,940,915	\$ 5,504,964	\$ 6,244,943	\$ 6,726,993	\$ –	\$ 195,256,147	\$ 5,861,600	\$ 69,275,818	\$ 1,152,143	\$ 261,659	\$ –	\$ 71,531,999	\$ 1,068,900	\$ 1,930,057	\$ 18,814,194	\$ 5,005,162	\$ 39,000	\$ 1,576,068	\$ –	\$ 508,791,526	\$ 1,911,605	\$ 510,703,131
EXPENSES																								
Service Expenses:																								
Treatment Services																								
501	Counseling																							
a	1 Counseling, Individual	2,143,820	1,146,812	113,359	208,546	343,253	–	3,646,556	98,379	2,362,277	20,067	28,944	–	2,591,057	83,435	96,016	627,569	–	–	–	–	13,510,092	–	13,510,092
	2 Counseling, Family	3,168,560	1,100,914	249,851	303,849	490,508	–	114,501	11,458	82,161	8,257	11,614	–	161,837	3,537	8,414	53,381	–	–	–	–	5,768,843	–	5,768,843
	3 Counseling, Group	379,071	211,586	8,820	35,731	60,430	–	1,542,411	10,332	638,717	5,497	903	–	4,571,569	44,253	340,784	2,194,238	–	–	–	–	10,044,345	–	10,044,345
	Consultation, Assessment & Specialized Testing	2,779,512	851,069	258,457	270,485	399,318	–	895,828	85,863	535,298	4,551	28,547	–	2,632,058	70,533	151,880	1,042,219	–	–	–	–	10,005,618	–	10,005,618
b	Other Professional	50,349	910	–	–	–	–	40,506	–	5,232	–	–	–	44,832	1,706	3,426	21,803	–	–	–	–	168,764	–	168,764
Total Treatment Services		8,521,313	3,311,291	630,487	818,612	1,293,509	–	6,239,803	206,032	3,623,686	38,372	70,008	–	10,001,353	203,464	600,520	3,939,210	–	–	–	–	39,497,662	–	39,497,662
502	Rehabilitation Services																							
a	Living Skills Training	8,132,399	1,858,607	624,034	549,825	634,923	–	8,846,885	34,846	2,622,899	20,862	–	–	839,483	698	38,509	244,317	–	–	–	–	24,448,287	–	24,448,287
b	Cognitive Rehabilitation	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
c	Health Promotion	78,340	27,438	11,947	6,591	11,632	–	958,408	16,294	297,803	884	–	–	118,313	–	4,038	25,621	–	–	–	–	1,557,310	–	1,557,310
d	Supported Employment Services	8,400	2,355	650	1,302	593	–	5,095,102	2,111	2,261,956	20,355	–	–	753,414	–	14,688	102,841	–	–	–	–	8,263,766	–	8,263,766
Total Rehabilitation Services		8,219,140	1,888,399	636,630	557,718	647,148	–	14,900,395	53,251	5,182,658	42,101	–	–	1,711,211	698	57,235	372,778	–	–	–	–	34,269,363	–	34,269,363
503	Medical Services																							
a	Medication Services	–	946	4	8	–	–	365,682	–	42,389	1,032	–	–	2,604,466	18,462	111,326	706,470	–	–	–	–	3,850,784	–	3,850,784
b	Medical Management	2,005,896	398,183	325,653	113,933	272,493	–	6,657,449	156,530	3,944,013	74,340	21,557	–	1,980,041	72,532	64,285	413,630	–	–	–	–	16,500,535	–	16,500,535
c	Laboratory, Radiology & Medical Imaging	87,730	24,687	13,817	4,418	10,783	–	1,008,233	34,203	1,209,908	2,147	409	–	330,962	2,474	22,721	210,675	–	–	–	–	2,963,170	–	2,963,170
d	Electro–Convulsive Therapy	–	–	–	–	–	–	158,466	–	164,577	–	–	–	66,701	–	101	984	–	–	–	–	390,828	–	390,828
e	Total Medical Services	2,093,626	423,817	339,474	118,358	283,276	–	8,189,829	190,734	5,360,887	77,519	21,966	–	4,982,170	93,468	198,433	1,331,759	–	–	–	–	23,705,317	–	23,705,317
504	Support Services																							
a	Case Management	13,692,472	7,247,543	1,472,419	1,157,332	1,586,645	–	40,430,441	227,643	20,840,324	201,848	95,824	–	6,234,525	69,216	362,201	2,309,064	–	–	–	–	95,927,498	–	95,927,498
b	Personal Assistance	846,533	78,604	262,160	94,721	11,240	–	18,585,075	1,588	4,252,743	9,495	–	–	806,256	–	17,854	113,270	–	–	–	–	25,079,539	–	25,079,539
c	Family Support	3,656,478	899,495	530,984	237,438	350,024	–	160,648	2,515	55,819	–	6,198	–	116,389	974	11,007	69,834	–	–	–	–	6,097,801	–	6,097,801
d	Peer Support	43,307	35,240	8,095	5,265	1,000	–	3,242,034	1,090	1,078,987	2,078	490	–	1,072,240	6,096	89,284	566,447	–	–	–	–	6,151,653	–	6,151,653
	Therapeutic Foster Care Services	1,574,455	5,963,133	309,609	189,746	–	–	728,304	–	151,553	–	–	–	236,119	–	–	–	–	–	–	–	9,152,918	–	9,152,918
f	Respite Care	1,372,174	386,372	50,788	97,997	48,054	–	409	–	–	–	–	–	4,902	–	565	3,586	–	–	–	–	1,964,847	–	1,964,847
g	Housing Support	–	–	–	–	–	–	–	–	5,612,470	–	–	–	–	–	–	–	–	–	–	–	5,612,470	–	5,612,470
h	Interpreter Services	373,189	28,763	26,042	23,504	69,834	–	269,521	2,581	46,033	971	1,275	–	77,282	8,035	3,524	22,356	–	–	–	–	952,910	–	952,910
i	Flex Fund Services	1,307	–	–	290,631	–	–	–	–	320,283	–	–	–	3,673	–	297	2,893	–	–	–	–	619,085	–	619,085
j	Transportation	680,986	241,463	39,383	50,016	42,582	–	6,811,409	19,573	3,655,891	5,795	317	–	1,874,266	9,700	147,701	1,110,269	–	–	–	–	14,689,351	–	14,689,351
k	Block Purchase NTXIX	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
l	Consumer Drop In Center	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
505	Total Support Services	22,240,900	14,880,613	2,699,480	2,146,649	2,109,379	–	70,227,841	254,990	36,014,102	220,187	104,103	–	10,425,652	94,022	632,433	4,197,719	–	–	–	–	166,248,072	–	166,248,072
Crisis Intervention Services																								
a	Crisis Intervention – Mobile	1,285,800	767,106	155,958	221,114	195,107	–	5,527,466	310,243	2,063,504	10,633	8,440	–	1,292,519	60,831	326,338	3,223,440	–	–	–	–	15,448,499	–	15,448,499
b	Crisis Services	444,566	128,483	37,732	5,536	25,677	–	6,337,667	55,016	1,736,434	19,254	27,353	–	3,500,680	102,625	72,950	872,642	–	–	–				

Magellan Health Services of Arizona, Inc.

Statement of Activities (continued)

**Disclose on Schedule A																										
			TXIX Child	TXIX CMDP	TXIX DD Child	NTXIX/XXI Child	TXXI Child	HB2003 Child	TXIX SMI	TXIX DD ADULT	NTXIX/XXI SMI	HIFA II SMI	TXXI Adult	SSDI – TMC	TXIX GMHSA	HIFA II GMH	MENTAL HEALTH	Substance Abuse	prevention intervention	PASRR	ADHS DOC	Other	Sub Total	Program Admin & Mgmt/Gen	Total	
b	2	Detoxification (Provider Types 02 & 71) Sub acute Facility	18,101	7,152	–	–	6,357	–	219,616	–	42,638	–	–	–	518,090	–	5,696	55,527	–	–	–	–	873,176	–	873,176	
	1	Psychiatric (Provider Types B5 & B6) Detoxification (Provider Types B5 & B6)	–	–	–	–	–	–	2,840,760	2,556	1,874,693	–	–	–	365,031	1,609	50,168	319,764	–	–	–	–	5,454,581	–	5,454,581	
	2	Residential Treatment Center (RTC)	–	–	–	–	–	–	111,065	–	22,076	–	–	–	1,060,855	10,283	140,815	893,377	–	–	–	–	2,238,470	–	2,238,470	
		Psychiatric – Secure & Non–Secure Provider																								
c	1	Types 78,B1,B2,B3) Detoxification – Secure & Non–Secure (Provider Types (78,B1,B2,B3)	4,658,355	9,609,624	289,647	130,113	296,111	–	271,148	–	692,661	–	–	–	964,441	–	111,242	1,084,382	–	–	–	–	18,107,723	–	18,107,723	
	2	Inpatient Services, Professional	–	1,963	–	–	–	–	928	–	–	–	–	–	587	–	–	–	–	–	–	–	3,478	–	3,478	
d			44,308	46,448	6,018	1,093	4,800	–	277,590	1,333	119,728	1,568	–	–	220,525	337	8,202	73,629	–	–	–	–	805,580	–	805,580	
e		Total Inpatient Services	6,574,914	10,975,124	533,016	193,159	441,319	–	19,175,495	368,514	12,278,533	17,867	–	–	11,276,928	12,229	1,153,089	8,631,448	–	–	–	–	71,631,634	–	71,631,634	
507		Residential Services																								
	a	Level II Behavioral Health Residential Facilities	696,548	2,836,924	–	71,835	–	–	14,983,189	–	4,741,579	–	–	–	5,259,358	11,444	201,670	1,376,494	–	–	–	–	30,179,040	–	30,179,040	
	b	Level III Behavioral Health Residential Facilities	179,687	249,741	–	43,504	–	–	–	2,472,474	–	424,605	–	–	–	73,968	–	679	4,310	–	–	–	–	3,448,968	–	3,448,968
	c	Room and Board	176,356	199,123	27,041	10,154	–	–	–	1,648,395	–	594,634	–	–	–	836,928	1,659	37,925	251,162	–	–	–	–	3,783,378	–	3,783,378
d		Total Residential Services	1,052,591	3,285,788	27,041	125,494	–	–	19,104,057	–	5,760,818	–	–	–	6,170,253	13,102	240,275	1,631,966	–	–	–	–	37,411,386	–	37,411,386	
508		Behavioral Health Day Program																								
a		Supervised Day Program	27,084	1,614	–	–	208	–	1,254,267	–	388,463	–	–	–	64,393	–	2,628	16,675	–	–	–	–	1,755,332	–	1,755,332	
b		Therapeutic Day Program	476,549	146,115	34,746	14,351	31,126	–	2,197,506	9,738	619,622	–	1,870	–	1,376,428	11,235	110,830	772,178	–	–	–	–	5,802,293	–	5,802,293	
c		Medical Day Program	–	–	–	–	–	–	94	–	19	–	–	–	–	–	–	–	–	–	–	–	113	–	113	
d		Total Behavioral Health Day Program	503,633	147,728	34,746	14,351	31,333	–	3,451,867	9,738	1,008,103	–	1,870	–	1,440,821	11,235	113,458	788,852	–	–	–	–	7,557,738	–	7,557,738	
509		Prevention Services																								
a		Prevention	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	4,417,769	–	–	–	4,417,769	–	4,417,769	
b		HIV	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	790,029	–	–	–	–	790,029	–	790,029	
c		Total Prevention Services	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	790,029	4,417,769	–	–	–	5,207,798	–	5,207,798	
510		Medication																								
a		Medication Expense	8,947,739	3,358,346	898,604	780,929	903,973	–	15,141,993	119,091	12,379,516	52,675	27,886	–	13,186,990	201,861	201,434	1,963,576	–	–	–	–	58,164,613	–	58,164,613	
b		Less Pharmacy Rebate Received	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	
c		Pharmacy Rebate Related Expense	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	
d		Total Medication Services	8,947,739	3,358,346	898,604	780,929	903,973	–	15,141,993	119,091	12,379,516	52,675	27,886	–	13,186,990	201,861	201,434	1,963,576	–	–	–	–	58,164,613	–	58,164,613	
		Other ADHS Service Expenses Not Rpt'd Above*	1,362,171	666,376	94,204	–	115,116	–	3,341,321	100,307	–	23,548	4,478	–	1,224,091	18,292	–	50,000	–	–	39,000	–	7,038,903	–	7,038,903	
511		ADHS/DOC COOL	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1,145,358	–	1,145,358	–	1,145,358	
512		Subtotal ADHS Service Expenses	61,254,648	39,837,385	6,088,311	4,982,668	6,046,126	–	174,294,802	1,751,710	86,054,113	504,954	269,720	–	65,423,764	836,696	3,662,422	28,439,295	4,417,769	39,000	1,145,358	–	485,048,748	–	485,048,748	
513		Service Expenses from Non ADHS Sources*	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	
520		Total Service Expense	61,254,648	39,837,385	6,088,311	4,982,668	6,046,126	–	174,294,802	1,751,710	86,054,113	504,954	269,720	–	65,423,764	836,696	3,662,422	28,439,295	4,417,769	39,000	1,145,358	–	485,048,748	–	485,048,748	
Administrative Expenses:																										
601		Salaries	1,577,596	1,026,001	156,803	128,327	155,716	–	4,488,914	45,115	2,216,300	13,005	6,947	–	1,684,971	21,549	94,325	732,446	113,778	–	29,498	–	12,491,291	–	12,491,291	
602		Employee Benefits	621,557	404,234	61,779	50,560	61,351	–	1,768,587	17,775	873,200	5,124	2,737	–	663,862	8,490	37,163	288,576	44,828	–	11,622	–	4,921,443	–	4,921,443	
		Professional & Outside Services	204,403	132,935	20,316	16,627	20,176	–	581,612	5,845	287,158	1,685	900	–	218,315	2,792	12,221	94,900	14,742	–	3,822	–	1,618,450	–	1,618,450	
603		Travel	74,014	48,136	7,357	6,021	7,306	–	210,601	2,117	103,979	610	326	–	79,052	1,011	4,425	34,363	5,338	–	1,384	–	586,039	–	586,039	
604		Occupancy	120,002	78,044	11,927	9,761	11,845	–	341,455	3,432	168,586	989	528	–	128,170	1,639	7,175	55,715	8,655	–	2,244	–	950,167	–	950,167	
605		Depreciation	113,350	73,718	11,266	9,220	11,188	–	322,526	3,241	159,240	934	499	–	121,064	1,548	6,777	52,626	8,175	–	2,119	–	897,493	–	897,493	
606		All Other Operating*	2,041,219	1,309,722	199,544	157,056	199,910	–	5,764,764	63,348	2,712,462	17,826	8,865	–	2,161,435	27,856	115,441	896,419	139,250	–	36,102	–	15,851,217	–	15,851,217	
607		Subtotal ADHS Administrative Expenses	4,752,141	3,072,789	468,992	377,572	467,491	–	13,478,459	140,872	6,520,925	40,173	20,802	–	5,056,869	64,885	277,527	2,155,045	334,765	–	86,792	–	37,316,100	–	37,316,100	
608		Non ADHS Administrative Expenses*	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	
650		Unrelated Admin. Expense*	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	
651		SubtotalAdministrative Expense	4,752,141	3,072,789	468,992	377,572	467,491	–	13,478,459	140,872	6,520,925	40,173	20,802	–	5,056,869	64,885	277,527	2,155,045	334,765	–	86,792	–	37,316,100	–	37,316,100	
652																										

Magellan Health Services of Arizona, Inc.

Statement of Activities (continued)

**Disclose on Schedule A

		TXIX Child	TXIX CMDP	TXIX DD Child	NTXIX/XXI Child	TXXI Child	HB2003 Child	TXIX SMI	TXIX DD ADULT	NTXIX/XXI SMI	HIFA II SMI	TXXI Adult	SSDI – TMC	TXIX GMHSA	HIFA II GMH	MENTAL HEALTH	Substance Abuse	prevention intervention	PASRR	ADHS DOC	Other	Sub Total	Program Admin & Mgmt/Gen	Total
701	Unrelated Business Expenses*	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
790	Income Tax Provisions																							
a	ADHS Income Tax Provision	7,941,171	(2,318,682)	(614,734)	502,657	124,646	–	4,371,202	2,318,541	(13,610,469)	344,881	(16,861)	–	614,166	97,741	(1,174,098)	(6,881,488)	147,575	–	195,401	–	(7,958,352)	–	(7,958,352)
b	Non ADHS Income Tax Provision	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1,120,316	1,120,316
	Subtotal Income Tax Provision	7,941,171	(2,318,682)	(614,734)	502,657	124,646	–	4,371,202	2,318,541	(13,610,469)	344,881	(16,861)	–	614,166	97,741	(1,174,098)	(6,881,488)	147,575	–	195,401	–	(7,958,352)	1,120,316	(6,838,036)
799		73,947,960	40,591,492	5,942,569	5,862,897	6,638,263	–	192,144,463	4,211,123	78,964,569	890,008	273,661	–	71,094,799	999,322	2,765,851	23,712,852	4,900,109	39,000	1,427,551	–	514,406,496	1,120,316	515,526,812
800	TOTAL EXPENSES																							
801	INC/(DEC) IN NET ASSETS/EQUITY	\$ 5,653,004	\$ (1,650,577)	\$ (437,605)	\$ 382,046	\$ 88,730	\$ –	\$ 3,111,684	\$ 1,650,477	\$ (9,688,751)	\$ 262,135	\$ (12,002)	\$ –	\$ 437,200	\$ 69,578	\$ (835,794)	\$ (4,898,658)	\$ 105,053	\$ –	\$ 148,517	\$ –	\$ (5,614,970)	\$ 791,289	\$ (4,823,681)

*Disclose on Schedule A

Magellan Health Services of Arizona, Inc.

Statement of Activities—Schedule A Disclosure

June 30, 2008

	TXIX Child	TXIX CMDP	TXIX DD Child	NTXIX/X XI Child	TXXI Child	HB2003 Child	TXIX SMI	TXIX DD ADULT	NTXIX/X XI SMI	HIFA II SMI	TXXI Adult	SSDI - TMC	TXIX GMHSA	HIFA II GMH	Mental Health	Substanc e Abuse	Preventi on interventi on	PASRR	ADHS DOC	Other	Sub Total	Program Admin/M gmt/ Gen	Total
Disclosure of other adhs revenue																							
																						-	-
																						-	-
Total Other - Other Column	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DISCLOSURE OF OTHER GRANTS REPORTED ON LINE 402																							
Itemization of Items Reported on Line 402																						-	-
Total Other Grants	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
DISCLOSURE OF OTHER REVENUE REPORTED ON LINE 4-6																							
Itemization of Items Reported on Line 4-6																						-	-
Total Other Revenue	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
UNRELATED BUSINESS ACTIVITIES REPORTED ON LINE 4-7																							
Itemization of Items Reported on Line 4-7																						-	-
Total Unrelated Business Activities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DISCLOSURE OF ALL OTHER BEHAVIORAL HEALTH SERVICES ON LINE 511																							
Encounter Withhold - Medical LARK Expenses	1,362,171	666,376	94,204	-	115,116	-	3,341,321	100,307	-	23,548	4,478	-	1,224,091	18,292	-	50,000					6,949,903		6,949,903
PASRR Expenses																		39,000			50,000		50,000
Total All Other Behavioral Health Services	1,362,171	666,376	94,204	-	115,116	-	3,341,321	100,307	-	-	4,478	-	1,224,-91	18,292	0	50,000	-	39,000	-	-	7,038,903	-	7,038,903
DISCLOSURE OF SERVICES EXPENSES FROM NON ADHS SOURCES ON LINE 520																							
Itemization of Items Reported on Line 520																						-	-
Total Service Expenses Non-ADHS Sources	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DISCLOSURE OF ALL OTHER OPERATING ON LINE 607																							
Telephone	25,510	16,590	2,536	2,075	2,518	-	72,586	730	35,838	210	112	-	27,246	348	1,525	11,844	1,840	-	477	-	201,984	-	201,984
Training	20,240	13,163	2,012	1,646	1,998	-	57,590	579	28,434	167	89	-	21,617	276	1,210	9,397	1,460	-	378	-	160,256	-	160,256
Supplies	33,080	21,514	3,288	2,691	3,265	-	94,126	946	46,473	273	146	-	35,332	452	1,978	15,358	2,386	-	619	-	261,925	-	261,925
Repairs & Maint	39,439	25,650	3,920	3,208	3,893	-	112,221	1,128	55,406	325	174	-	42,123	539	2,358	18,311	2,844	-	737	-	312,276	-	312,276
Postage	23,469	15,263	2,333	1,909	2,316	-	66,779	671	32,970	193	103	-	25,066	321	1,403	10,896	1,693	-	439	-	185,825	-	185,825
Office Moving Exp	19,722	12,827	1,960	1,604	1,947	-	56,118	564	27,707	163	87	-	21,065	269	1,179	9,157	1,422	-	369	-	156,160	-	156,160
Promotional	61,816	40,202	6,144	5,028	6,1-2	-	175,892	1,768	86,843	510	272	-	66,023	844	3,696	28,700	4,458	-	1,156	-	489,453	-	489,453
Licenses & Reg Fees	864	562	86	70	85	-	2,459	25	1,214	7	4	-	923	12	52	401	62	-	16	-	6,842	-	6,842

Magellan Health Services of Arizona, Inc.

Statement of Activities—Schedule A Disclosure (continued)

	TXIX Child	TXIX CMDP	TXIX DD Child	NTXIX/X XI Child	TXXI Child	HB2003 Child	TXIX SMI	TXIX DD ADULT	NTXIX/X XI SMI	HIFA II SMI	TXXI Adult	SSDI - TMC	TXIX GMHSA	HIFA II GMH	Mental Health	Substanc e Abuse	Preventi on interventi on	PASRR	ADHS DOC	Other	Sub Total	Program Admin/M gmt/ Gen	Total
Ins & Bank Charges	34,121	22,191	3,391	2,776	3,368	–	97,089	976	47,936	281	150	–	36,444	466	2,040	15,842	2,461	–	638	–	270,171	–	270,171
Interest Exp LOC Fees - Deutsche	5,257	3,419	523	428	519	–	14,958	150	7,385	43	23	–	5,615	72	314	2,441	379	–	98	–	41,624	–	41,624
Perf Sanction Accrual	31,875	20,730	3,168	2,593	3,146	–	90,697	912	44,779	263	140	–	34,044	435	1,906	14,799	2,299	–	596	–	252,381	–	252,381
Encounter Withhold - Admin	110,446	54,031	7,638	0	9,334	–	270,918	8,133	0	1,909	363	–	99,251	1,483	0	0	0	–	0	–	563,506	–	563,506
Other Exp (sum)	31,808	20,687	3,162	2,587	3,14–	–	90,508	910	44,686	262	140	–	33,973	434	1,902	14,768	2,294	–	595	–	251,856	–	251,856
SBU Allocation	86,537	56,280	8,601	7,039	8,542	–	246,235	2,475	121,573	713	381	–	92,427	1,182	5,174	40,178	6,241	–	1,618	–	685,197	–	685,197
Corp Alloc	1,517,034	986,613	150,783	123,401	149,738	–	4,316,588	43,383	2,131,217	12,506	6,680	–	1,620,286	20,722	90,704	704,328	109,411	–	28,366	–	12,011,759	–	12,011,759
Total All Other Operating	\$ 2,041,219	\$ 1,309,722	\$ 199,544	\$ 157,056	\$ 199,910	\$ –	\$ 5,764,764	\$ 63,348	\$ 2,712,462	\$ 17,826	8,865	\$ –	\$ –	\$ 27,856	\$ 115,441	\$ 896,419	\$ 139,250	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –
DISCLOSURE OF NON-ADHS ADMINISTRATIVE EXPENSES ON LINE 650																							
Itemization of Items Reported on Line 650																							
Encounter Withhold	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
LOC Interest Expense																							
Total Non-ADHS Admin. Expense	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –
DISCLOSURE OF UNRELATED ADMINISTRATIVE EXPENSES ON LINE 651																							
Itemization of Items Reported on Line 651																							
Total Unrelated Administrative Expenses	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –
DISCLOSURE OF UNRELATED BUSINESS EXPENSES LINE 701																							
Itemization of Items Reported on Line 701																							
Total Unrelated Business Expenses	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities

June 30, 2008

1. Organization

Magellan Health Services of Arizona, Inc. (the Company) is a wholly owned subsidiary of Magellan Behavioral Health, Inc. (the Parent), which is a wholly owned subsidiary of Magellan Health Services, Inc. (Magellan). Magellan is engaged in the specialty managed healthcare business, and provides managed behavioral healthcare services, radiology benefits management and specialty pharmaceutical management.

The Company was incorporated and organized in 2004 as a behavioral health organization. In 2007, the Company was awarded a contract with the Arizona Department of Health Services (ADHS) which commenced September 1, 2007 and expires June 30, 2010 (the Contract). In accordance with the Contract, the Company has been designated as the Regional Behavioral Health Authority (RBHA) for the geographic service area of Maricopa County. The Company is responsible for managing and maintaining an organized, comprehensive behavioral healthcare delivery system for the benefit of eligible members within its geographic service area. All of the Company's revenues and accounts receivable are from the Contract.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying statement of activities has been prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States.

The Company follows the ADHS-DBHS Financial Reporting Guide for Regional Behavioral Health Authorities and Tribal Behavioral Health Authorities with an effective date of July 1, 2007 ("the Reporting Guide"). The Reporting Guide contains prescribed reporting guidelines for the preparation of the accompanying statement of activities. In accordance with these guidelines the Company records revenues and expenses in columns ("Fund Sources") representing programs administered by the ADHS-DBHS. In addition, the Company records service expense in rows ("Types of Service") based on Exhibit A of the Reporting Guide.

Contract Revenue

The Company receives all of its revenue from the Contract. Contract revenues include funds for behavioral healthcare services and prevention programs for youth, seriously mentally ill ("SMI") adults, and substance abuse populations under three major types of revenue sources: Title XIX, Title XXI, and Non-Title XIX. Contract revenue is recognized in the period for which the Company is obligated to provide covered services. Contract revenue is also limited by the terms of the Contract to a maximum profit percentage. Amounts limited by the profit percentage are recorded as a payable to ADHS.

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

2. Summary of Significant Accounting Policies (continued)

Contract Revenue (continued)

Title XIX Revenue

The Contract requires the Company to provide behavioral healthcare services to all eligible enrollees within its geographic service area. Under this agreement, the Company receives monthly capitation payments from the ADHS-DBHS based on a capitated rate and the number of Title XIX Arizona Health Care Cost Containment System (“AHCCCS”) enrollees eligible for covered services during that month. In addition, the Company also receives revenue for Preadmission Screening and Resident Review (“PASSAR”) screenings on a fee-for-service basis from the ADHS-DBHS.

Title XXI Revenue

The Contract requires the Company to provide behavioral healthcare services to all eligible enrollees within its geographic service area. Under this agreement, the Company receives monthly capitation payments from the ADHS-DBHS based on a capitated rate and the number of Title XXI Arizona Health Care Cost Containment System (“AHCCCS”) enrollees eligible for covered services during that month.

Non-Title XIX Revenue

The Contract provides for payment to the Company at a monthly rate specified by annual contract maximums under the ADHS-DBHS Non-Title XIX programs. Revenues for these contracts are recognized ratably over the course of each fiscal year. These programs provide behavioral healthcare services to lower income uninsured or underinsured individuals not eligible for behavioral healthcare coverage under Title XIX or Title XXI. Non-Title XIX programs are funded through a combination of federal behavioral healthcare block grant funds, State of Arizona funds, and Maricopa County funds administered by ADHS-DBHS.

Other Revenue

Under the Contract, the Company is required to provide services under certain grants for special populations. Payment is made by the ADHS-DBHS based on expenditure reports submitted by the Company. The Contract allows for performance incentives to be earned by the Company based on various operation and reporting performance requirements as defined in the Contract. These incentive payments are specifically excluded from both administrative and profit

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

2. Summary of Significant Accounting Policies (continued)

Other Revenue (continued)

limitations. Interest income on the Company's investments, cash and cash equivalents is recorded in Program Administration and Management & General. These revenues are not included in the calculations on profit limitations.

Service Expense

Program services include costs purchased under fee-for-service or block purchase arrangements, as well as costs incurred by the Company to operate its wholly owned healthcare Clinics (Clinics). Fee-for-service contract expenses are accrued as incurred. Program services provided under block purchase arrangements are accrued based upon contract terms. From time-to-time, the Company amends its provider contracts. The effects of these amendments are recorded in the period in which the amendment was executed. Expenses for the Clinics include salaries, rent, utilities and other operating costs, all of which are recognized as incurred.

Service expense is recorded in each Fund Source as follows:

Block Purchase Arrangements

The Company contracts with its providers under block purchase arrangements for services provided to consumers meeting the eligibility requirements for each Fund Source with the exception of Title XIX Developmentally Disabled ("DD") Child and Title XIX DD Adult. Consumers eligible for services under these Fund Sources are contracted for under block purchases for all other Fund Sources. Service expense allocated to these Fund Sources is estimated based on available eligible consumers' utilization related to the year ended June 30, 2008. Service expense is recorded in all other Fund Sources based on the explicitly contracted amounts in the block purchase arrangements after giving effect to the allocations described above.

Fee For Service Arrangements

The Company records service expense under fee-for-service arrangements based on actual and estimated services rendered to consumers meeting the eligibility requirements for each fund source.

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

2. Summary of Significant Accounting Policies (continued)

Service Expense (continued)

Services Provided Directly by the Company

The Company records Direct Care Clinic and Urgent Psychiatric Care Center services provided directly by the Company in each Fund Source based on the proportion of consumers receiving these services that meet the eligibility requirements for each Fund Source. All other services provided by the Company are allocated to Fund Sources based on revenue.

The Company primarily allocated total service expense to Types of Service within each Fund Source using the ratio of consumer encounter values received for each Type of Service to total consumer encounter values received for each Fund Source. Service expense allocated to the Types of Service is estimated based on available eligible consumers' utilization related to the year ended June 30, 2008 based on consumer encounter values available as of July 1, 2008.

Supportive Housing, Crisis, Prevention, and Medication service expense are reflective of the actual expense incurred and excluded from the allocation process described above.

For PASAAR and ADHS-DOC Fund Sources, the Company reports service expense in total only.

Use of Estimates

The preparation of the statement of activities requires management to make estimates and assumptions that affect the reported amounts of revenue and expenses during the reporting period. Significant estimates of the Company include, among other things, accounts receivable realization, medical claims payable and legal liabilities. Actual results could differ from those estimates.

The IBNR (claims incurred but not reported) portion of service expense is estimated based on past claims payment experience for member groups, enrollment data, utilization statistics, authorized healthcare services and other factors. This data is incorporated into contract-specific actuarial reserve models and is further analyzed to create "completion factors" that represent the average percentage of total incurred claims that have been paid through a given date after being incurred. Factors that affect estimated completion factors include benefit changes, enrollment changes, shifts in product mix, seasonality influences, provider reimbursement changes, changes in claims inventory levels, the speed of claims processing, and changes in paid claim levels. Completion factors are applied to claims paid through the fiscal year end date to estimate the

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates (continued)

ultimate claim expense incurred for the current period. Actuarial estimates of claim liabilities are then determined by subtracting the actual paid claims from the estimate of the ultimate incurred claims. For the most recent incurred months (generally the most recent two months), the percentage of claims paid for claims incurred in those months is generally low. This makes the completion factor methodology less reliable for such months. Therefore, incurred claims for any month with a completion factor that is less than 70 percent are generally not projected from historical completion and payment patterns; rather they are projected by estimating claims expense based on recent monthly estimated cost incurred per member per month times membership, taking into account seasonality influences, benefit changes and health care trend levels, collectively considered to be “trend factors.”

Administrative Expense

Total administrative expenses are limited by the Contract to 7.5% of contract revenue for all programs. In accordance with the Contract, income tax expense is not included as an administrative expense of the Company that is subject to the limitation. The Contract limits the percentage of administrative expense incurred outside of Arizona to 35% of total available administrative revenue for all programs. Administrative expenses are allocated to Fund Source based on proportionate service expense.

Income Taxes

The provision for income taxes is computed using the statutory rate, based on the Company’s income, after giving effect to any permanent differences. The Company computes the income tax expense attributable to each Fund Source by applying the Company’s effective tax rate to net income before income taxes for each Fund Source.

Depreciation

The Company provides for depreciation using the straight-line method over the following general range of estimated useful lives:

Computer hardware and software	3-5 years
Furniture	15 years
Equipment	5 years
Leasehold improvements	5 years
Capital leases – equipment	4 years
Clinic assets	18 months

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

3. Allocated Corporate Income Tax Benefit

For federal income tax reporting purposes, the Company's operations are included in Magellan's consolidated federal income tax returns. Magellan has a federal income tax year end of December 31. The Company files a separate state income tax return. Both Magellan and the Company file their federal and state returns on a calendar year basis.

The Company has a tax sharing allocation agreement with Magellan. Under the terms of this agreement, Magellan has allocated a \$6.8 million federal tax benefit to the Company for the year ended June 30, 2008. The agreement calls for an allocation based on Magellan's federal statutory rate and the applicable state rate before reflecting the allocation and after affecting for permanent differences. For the statutory year ended June 30, 2008, the Company's permanent differences mainly consisted of \$7.9 million of overhead allocations for tax purposes which exceeded those recorded for book purposes due to limitations under the Contract. In accordance with the tax allocation agreement, allocated corporate federal income taxes payable or recoverable are required to be settled within 30 days after the filing by Magellan of any annual federal income tax return that includes the activities of the Company.

The benefit for income taxes for the year ended June 30, 2008 consisted of the following:

Income taxes currently receivable:	
Federal	\$ 150,543
State	—
	<u>150,543</u>
Deferred income taxes:	
Federal	6,687,493
State	—
	<u>6,687,493</u>
	<u><u>\$ 6,838,036</u></u>

As of June 30, 2008, the Company's valuation allowance was \$0.9 million, which primarily relates to certain state net operating losses and other state deferred tax assets.

4. Related Party Balances and Transactions

Magellan and affiliated companies provide administrative and other services to the Company, including systems functions, accounts payable and payroll processing. Included in general and administrative expenses is an allocation of the costs of the administrative services provided by affiliated companies. The Company's allocation was \$24.9 million for the year ended June 30, 2008.

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

4. Related Party Balances and Transactions (continued)

Amounts due to affiliated companies are due on demand and are non-interest bearing.

Under the provisions of the Contract, equity distributions may be paid to the Parent only to the extent of allowable profit in each of the funding sources as defined. For the year ended June 30, 2008, no distributions were declared or paid to the Parent.

5. Commitments and Contingencies

Capital Lease Obligation

The Company has a capital lease related to the purchase of equipment. The capital lease has an interest rate of 6.87% and has scheduled maturities of \$12,394, \$14,439, \$15,462 and \$9,521 for the years ended June 30, 2009, 2010, 2011 and 2012, respectively.

Operating Leases

Operating leases have been executed for various operating facilities and equipment which are used to support the Company's business. Certain of these leases have been executed by the Parent on behalf of the Company, and other leases have been executed by the Company itself. The leases generally require the payment of all maintenance, property taxes and insurance costs. For leases which have been executed by the Parent, actual lease costs incurred are charged directly to the Company. Total rent expense, inclusive of costs related to leases executed by the Parent, was \$6.9 million for the year ended June 30, 2008. Leases executed by the Company expire at various dates through August 31, 2015.

At June 30, 2008, aggregate amounts of future minimum payments under operating leases which have been executed by the Company were as follows:

Year ending June 30:	
2009	\$ 6,330,196
2010	4,577,898
2011	1,311,152
2012	403,174
2013	382,482
Thereafter	867,690
	<u>\$ 13,872,592</u>

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

5. Commitments and Contingencies (continued)

Regulatory Issues

The specialty managed healthcare industry is subject to numerous laws and regulations. The subjects of such laws and regulations cover, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, information privacy and security, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Over the past several years, government activity has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare organizations and insurers. Entities that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Legal

From time to time, the Company is involved in legal actions arising in the ordinary course of business. After taking into consideration legal counsel's evaluation of such actions, management believes that the resolution of such legal actions will not have a material adverse effect on the Company's financial condition or results of operations; however, there can be no assurance in this regard.

Insurance

The Company is covered under Magellan's general, professional and managed care liability insurance policies with unaffiliated insurers for a one year period, with the current policy extending from June 17, 2008 through June 17, 2009. The general liability policies are written on an "occurrence" basis, with the professional liability and managed care errors and omissions liability policies written on a "claims-made" basis.

In relation to the Company's planned divestiture of the Clinics, the Company intends to purchase professional and general liability tail insurance coverage. The Company is ratably accruing for the estimated cost of the tail insurance coverage over the first twelve months that the Company operates the clinics. As of June 30, 2008, the Company has accrued approximately \$ 3.7 million for tail insurance coverage.

Magellan Health Services of Arizona, Inc.

Notes to Statement of Activities (continued)

6. Contract Requirements

In accordance with the Contract, the Company is required to maintain certain minimum financial reporting and viability measures.

The Company must maintain unrestricted, minimum capitalization of at least ninety percent of the monthly capitation and block payments received under the Contract. At June 30, 2008, the Company was in compliance with this requirement.

The Contract contains various quarterly financial performance requirements, including required minimum liquidity ratio, administrative cost percentage and service expense percentages. The Company was not in compliance with certain administrative expense percentages and certain service expense percentages for the year ended June 30, 2008. The Company has informed ADHS of the reasons for these variances and ADHS has not informed the Company of any required corrective action.

Should the Company be in default of any material obligations under the Contract, ADHS may, at its discretion, in addition to other remedies, either adjust the amount of future payments or withhold future payment until satisfactory resolution of the default or exception. In addition, although it has not expressed an intention to do so, ADHS has the right to terminate the Contract in whole or in part without cause by giving the Company 90 days written notice. Further, if monies are not appropriated by the state or are not otherwise available, the Contract may be cancelled upon written notice until such monies are so appropriated or available.

As of June 30, 2008, the Company reported less than the minimum number of encounters as stipulated in the Contract and is subject to a potential encounter withhold by ADHS if no more encounters are submitted. The Company has until February 28, 2009 to submit encounters related to the year ended June 30, 2008. Due to the uncertainty as to whether the Company will meet the required encounter threshold, a liability in the amount of \$7.5 million has been recorded as of June 30, 2008. In addition, the Company is subject to a profit risk corridor calculation that calculates a return of premium to the extent certain financial ratios are not met by program types. The Company recorded a return of premium of approximately \$0.6 million as a result of the profit risk corridor calculation for the year ended June 30, 2008.

ADHS has the right to sanction the Company for other matters of non-compliance of the Contract, as determined by ADHS. As of June 30, 2008, the Company has accrued a liability in the amount of \$0.2 million for potential sanctions.

The Company is limited by the terms of the Contract to profit that can be earned under the various programs. Contract profit limitations are applied on an after-tax basis.

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